MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, 2019/ 2020

BAC3624 – ADVANCED AUDITING

(All sections / groups)

28 FEBRUARY 2020
9.00 a.m – 12.00 p.m
(3 Hours)

INSTRUCTIONS TO STUDENTS

1. This Question paper consists of 8 pages excluding cover page with **5** questions only.

2. Attempt ALL questions. The distribution of the marks for each question is given.

3. Write all your answers in the answer booklet provided.

QUESTION 1

a) The audit partner has requested you to help prepare a tender document for an external audit service of Budiman Berhad (Budiman). You have been asked to prepare the section that calculates the audit fee.

Identify the factors that have an effect on determining the audit fee to be included in the tender document.

(3 marks)

b) Your firm is the auditor of Mega Berhad and Ace Berhad.

(i) The firm performs tax services to Mega Berhad which involves completing the tax return forms for submission by client's management from the information extracted from the client's records.

(ii) The audit firm is also the auditor of Ace Berhad's largest customer.

Identify the potential threats to objectivity that each of the above situations pose to your audit firm and the safeguards that should be in place to address them.

(4 marks)

c) Describe why the audit of related party transactions is a challenging area for external auditors.

(4 marks)

d) The International Standard on Auditing (ISA) 240: The Auditor's Responsibilities Relating to Fraud in an audit of Financial Statements states that the risk of misstatement which can arise from fraud includes misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. It is further stated that the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

List the actions that can be taken by those charged with governance and the management to fulfill this responsibility.

(2 marks)

e) Financial statements contain many estimates which are often made when there are uncertainties about the outcome of events and involve the use of judgment. Consequently, the risk of material misstatements is higher when accounting estimates are involved.

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Explain how an auditor would approach the audit of allowance for doubtful debt account.

(4 marks)

f) You are the manager in-charge of the external audit of Gah Sdn. Bhd. (Gah) for the year ending 31 January 2020. Gah has twelve outlets throughout Malaysia including Brunei. In February 2020, Gah introduced an internal audit function to monitor those outlets. Based on your preliminary assessment of the internal audit function, you decide to use its work.

State the factors to consider when evaluating the work of Gah's internal audit function.

(3 marks)

(Total: 20 marks)

QUESTION 2

Your firm has recently been appointed as the external auditor of Zaza Berhad (Zaza) for the year ending 31 March 2018. Zaza was incorporated on 1 April 2016 and is owned equally by Bobo Berhad (Bobo) and Baba Berhad (Baba). Zaza was not required to have an audit for the year ended 31 March 2017. Your firm has been the external auditor of Bobo for many years but has no previous relationship with Baba.

Zaza was formed to develop and manufacture sportswear which has wearable technology woven into the fabric. The technology monitors athletic performance by providing data, such as heart rate and distance travelled, to a smartphone. Zaza has successfully developed the technology and negotiated two contracts with large retailers to sell its new sportswear. The contracts commenced in July 2017.

You are the senior responsible for planning the audit of Zaza. The engagement partner has asked you to consider the following key areas of audit risk:

(a) Going concern
(b) Intangible assets – development costs of wearable technology
(c) Trade payables

The development of the sportswear was funded by equity investment and loans from Bobo and Baba. During the year ending 31 March 2018, Zaza received a bank loan and has also made use of an overdraft facility. The terms of the bank loan require Zaza to maintain an interest cover of 1.5 times or higher. Zaza has asked its bank for an additional loan to develop the use of its technology in baby clothing. The directors of Zaza wish to diversify

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into baby clothing because the wearable technology sportswear market is highly competitive. Similar sportswear has been launched by other companies. During contract negotiations retailers pushed down prices and demanded extended credit terms of over 60 days. Zaza's bank has requested a copy of the audited financial statements for the year ending 31 March 2018 and will decide on the additional loan after it has reviewed them.

Zaza's management has provided you with the following financial information:

Forecast financial information from the statement of profit or loss for the year ending 31 March 2018

	RM'000
Cost of sales	(10,750)
Profit before interest and tax	2,984
Interest payable	(2,105)

Notes to the financial statements as at 31 March (extracts)

Intangible assets – development cost

	2018 (Forecast) RM'000	**2017 (Unaudited) RM'000**
Carrying amount at 1 April 2017	2,050	-
Additions	1,780	2,450
Amortisation charge	(430)	(400)
Carrying amount at 31 March 2018	3400	2050

Current liabilities

	2018 (Forecast) RM'000	**2017 (Unaudited) RM'000**
Trade payables	1,325	250
Bank overdraft	750	-

Development costs include salaries of employees working in the product development team and materials used in the development process for the wearable technology. In addition, the product development team uses equipment classified as plant and equipment. The depreciation charge on this equipment is included in development costs. The product development director also estimates the relevant proportion of overheads to attribute to development costs.

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Materials used in the product development and in the production processes are purchased from suppliers around the world. Suppliers invoice in their local currency. Credit terms are 30 days. The purchase ledger is currently being managed by Rahman. Rahman was seconded to Zaza from Bobo to save costs. He set up a spreadsheet to manage the purchase ledger but the time taken to do this has resulted in a large backlog of suppliers' invoices that have not been processed.

Chew, Bobo's finance director and a board member of Zaza, requested that your firm undertakes an additional engagement, for Bobo's board of directors. The engagement is to examine the five-year profit and cash flow forecasts of Zaza and prepare a report to the directors of Bobo which recommends whether Bobo should continue to support Zaza. Chew requested that your firm does not mention this engagement to any of Baba's representatives that are on Zaza's board of directors.

Required:

(i) Justify why the items listed by the engagement partner as (a), (b) and (c) have been identified as key areas of audit risk. For each item, describe the procedures that should be included in the audit plan to address those risks.

You should start each justification on a new line and present your answer in a two column format using the headings:

(a) Going concern
(b) Intangible assets – development costs of wearable technology
(c) Trade payables

(26 marks)

(ii) Assuming your firm concludes that there is uncertainty over whether Zaza is a going concern. State, with reasons, the implications for the auditor's report on the financial statements of Zaza for the year ending 31 March 2018.

(4 marks)

(iii) Zaza is a significant component of Baba and financial information relating to Zaza will be included in Baba's group financial statements for the year ending 31 March 2018. Your firm has not yet received any communication from Baba's auditor regarding its requirements.

List the requirements and information that you expect the external auditor of Baba to include in its communication to your firm.

(2 marks)
(Total: 32 marks)

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QUESTION 3

You are working in a well-established local audit firm which has seven audit partners. One day, you have been invited by Mr Ali Khan (Ali), the managing director and majority shareholder of Kalis Berhad (Kalis) to accept appointment as auditor of Kalis and also provide assistance with the preparation of the financial statements and the corporate tax computation.

The principal activity of Kalis is the production of paper carrier bags, serviettes, coffee cups and lids which are sold to customers operating in the fast food sector. Kalis was incorporated on 1st October 2018 and the financial statements will cover the 15 months period to 31st December 2019. Although Kalis's revenue and assets are below the thresholds for statutory audit purposes, the company's bankers require the annual accounts to be audited.

Ali started the business using a combination of money inherited from his grandfather and a bank loan. The loan agreement includes a covenant specifying that the company's debt equity ratio should not exceed parity (ie 1:1).

The accounting records are computerised and the company uses software which was developed by Excel Systems Sdn Bhd (Excel), a company owned by Ali's brother. The software has been customised to integrate inventory control with receivables and payables. Excel also provides support for Kalis's computer systems. The accounting records are maintained by Aminah assisted by Selvi who works one day a week and is responsible for payroll processing.

Required:

(i) State with reasons, the matters to be considered and the procedures to be performed prior to your firm accepting and commencing the audit of Kalis for the period ending 31st December 2019.

(8 marks)

(ii) Identify from the information provided above, the factors which should be taken into account when assessing the risk of material misstatement in the financial statements of Kalis and explain why such factors should be taken into account when conducting the audit.

(10 marks)

(Total: 18 marks)

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QUESTION 4

Described below are four situations which have arisen at four unrelated audit clients of your firm. The year end for each client is 31 January 2020.

(a) Derby Sdn. Bhd. (Derby)
Derby is your firm's listed audit client and it has expanded by acquiring a significant overseas subsidiary, Bangor Sdn. Bhd. (Bangor). Your firm is the group auditor except for Bangor, of which the financial statements are audited by an overseas auditor, Coventry & Co (Coventry). Your firm planned to rely on Coventry's work but they refused to cooperate. Your firm has no alternative audit procedures it can perform in respect of Bangor's financial statements. Bangor's results are highly material to a large number of items in Derby's group financial statements.

The directors of Derby have requested that your firm accepts the appointment as external auditor of Bangor for the year ending 31 January 2021 in order to avoid this issue arising next year. Your firm estimates the total audit fee for the year ended 31 January 2021 of the Derby group will be RM2.3 million and your firm's total annual fee income is likely to be RM29 million.

(b) Lisburn Sdn. Bhd. (Lisburn)
The financial statements of Lisburn include inventory at cost of RM1.25 million. The inventory was purchased on 4 January 2020 in anticipation of fulfilling a large order for a customer. However, the customer went into liquidation on 20 February 2020 and was unable to complete any part of the transaction with Lisburn. On 28 February 2020, Lisburn sold the inventory for RM1 million. The draft financial statements show that Lisburn's profit before tax is RM12 million and total assets are RM42 million.

(c) Plymouth Sdn. Bhd. (Plymouth)
The brother of the managing director of Plymouth owns Buggy Sdn. Bhd. (Buggy) a transportation business which Plymouth uses for some of its distribution requirements. The total amount paid by Plymouth to Buggy during the year was RM0.7 million. The directors of Plymouth have refused to disclose this transaction in the notes to the financial statements as they claim that the amount is too small to disclose. The draft financial statements show that Plymouth's profit before tax is RM18.4 million.

(d) Kingston Sdn. Bhd. (Kingston)
Kingston recognised payments received from customers for one month after the year end on the statement of financial position at the year end, as cash at bank. Your firm's audit has identified that as a result, cash was overstated by RM12 million and trade receivables understated by the same amount at the year end. The directors refuse to adjust the financial statements because the cash balance is one measure used by stakeholders to assess

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Kingston's financial performance. The draft financial statements show that Kingston's total assets are RM275 million.

Required:

(i) For each of the four situations above, state with reasons, the implications for your firm's audit or assurance report.

(12 marks)

(ii) For Derby, identify the threats to your firm's objectivity and state the steps that your firm should take to address them.

(3 marks)

(Total: 15 marks)

QUESTION 5

a) The University of Southern Malaysia (USM) has recently bought unused factory land next to its campus for expansion purposes. USM has received the planning permission to demolish the factory and plan to construct an engineering workshop and classrooms. Dr Syahir, the university's finance director has prepared cash flow forecasts in respect of the expansion plans for the five years ending 31 December 2025, which are to be submitted to the bank in support of a loan to finance the project. USM has requested your firm to examine and provide an assurance report on the cash flow forecasts.

Required:

Draft a report to Dr Syahir which:

(i) Lists the general representations that should be obtained from management as part of the assurance work on the cash flow forecasts and explains why such representations are required;

(3 marks)

(ii) Explains how the report on the cash flow forecast differs from the level of assurance provided by an auditor's report on annual financial statements.

(4 marks)

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Consequently, the management of Kopetro has strict procedures to ensure that compliance is in place.

During the external audit of Kopetro, your firm is planning to use data analytics routines to gain assurance that revenue is fairly stated in the financial statements for the year ended 30 November 2019. Kopetro's main revenue is based on the services that they provided and projects that they involved. The revenue is also contributed by 22 oil refining locations throughout the Asia region. Kopetro has utilised the revenue information system since year 2010.

Required:

(i) Identify the business risks to which accidental breaches of these regulations could expose Kopetro and the implications for the financial statements in the event of such breaches.

(4 marks)

(ii) List any four data analytics routines that your firm could perform on data from Kopetro's revenue information system.

(4 marks)

(Total: 15 marks)

End of Paper.